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DEPT FOR WHA/AND AND EB/OMA
TREASURY FOR STEPHEN GOOCH

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SUBJECT: Mixed Messages on Debt Renegotiation and GOE Approach to
Multilateral Lenders

¶1. (SBU) Summary. Minister of Economy Patino continues to send mixed messages on what the GOE wants to do on debt restructuring. On January 17, Patino, in an "aggressive" meeting with bondholders, said most of Ecuador's external debt is illegitimate and floated the idea of a 60 percent debt discount. Patino said that he wanted to explore a "friendly" restructuring, but creditors left the meeting believing that a market-based restructuring is unlikely. In an early January meeting with the IMF, Patino appeared to be interested in constructive alternatives for fulfilling campaign promises on social spending. However, the multilateral development banks remain concerned the GOE could default, and do not anticipate making many new loans to the central government. End summary.

Messy Meeting with Bondholders

¶2. (U) Citigroup organized a team of bondholders who met with Minister of Economy Ricardo Patino on January 17. According to the Citibank report on the meeting, Patino floated the idea of discount on debt, or "haircut," of 60% or more, although he stressed that was just one possibility and not necessarily supported by President Correa. He said that the GOE had about US\$ 1 billion to buy back commercial bonds, and wanted to test the idea of a friendly restructuring. The Citigroup report concluded that the meeting did not support a positive outlook for external debt and was pessimistic about the chances of a negotiated debt restructuring.

¶3. (SBU) EconCouns talked to several local and foreign analysts who had heard from the meeting participants that the meeting with Patino was much more antagonistic than implied by the Citigroup report, and that Patino took a very aggressive tone. One analyst reported that Patino asked each representative to stand up and announce how much Ecuadorian debt his institution held. When the representatives refused, for fiduciary reasons, Patino allegedly "lost it and turned red." One participant reported that "it looked like Patino had been waiting for 20 years for this meeting." The analysts concurred that Patino's performance indicated that he did not have a good idea of who he was dealing with (a group on a fact-finding mission) and is evidence of the GOE's inexperience in dealing with the international financial community.

¶4. (U) Prior to the meeting with Citigroup, Patino held a press conference, where he said the government's budget (which must be presented to congress by January 31) would include provisions to cover Ecuador's external debt obligations, but those provisions did not necessarily mean that Ecuador would pay. He repeated his line that the government would not necessarily honor debt obligation in order to first meet social needs.

Better Meeting with the IMF

15. (SBU) IMF staff met with Patino in early January before he took office, and on January 10 reported the results of the meeting to representatives of multilateral development banks and USAID Quito. The IMF team's objective in their meeting with Patino was to minimize the likelihood or extent of default by providing Ecuador with cost-savings means for meeting Ecuador's commitments and with a strong analysis of the costs of default. The IMF said that Patino was respectful, seeking advice on alternatives to meet promises for social spending made during the campaign, but reluctant to discuss whether the Government would declare a debt moratorium.

16. (SBU) IMF reported that Patino defines "illegitimate debt," which the GOE does not intend to pay, as that resulting from loan programs that did not achieve intended results. To help make these determinations, the Ministry of Economy requested that IDB provide evaluation reports of loans. Members of Jubilee 2000, an NGO that has called for the cancellation of unpayable debt, attended the IMF's meeting with Patino, "in the interest of transparency," and took a harder line than the minister-designate (Patino had been a member of Jubilee 2000).

17. (SBU) The IMF resident representative said that he expects the Correa administration will maintain a dialogue with the IMF, possibly including continued quarterly reviews. He said that Patino was receptive to the IMF suggestion that they send a review team to Ecuador in March or April.

Views of the Multilateral Development Banks

18. (SBU) At the January 10 IMF debriefing, the World Bank representative said that he believes that at least partial default

is more likely than not, noting that comments from Correa and his economic team about the World Bank have been especially negative. The World Bank representative would like to develop a common approach among lenders and donors to minimize the likelihood of default and assure a coordinated response if it occurs. The Interamerican Development Bank (IDB) reported that it would be prohibited from disbursing loans after a default, while the Andean Development Corporation (CAF) could disburse if it chose to.

19. (SBU) The IDB does not expect to sign or disburse new loans in the next several months. Significant disbursements for municipal infrastructure will continue, along with grants and modest technical assistance. Disbursement of a signed \$50 million loan for competitiveness is expected but not guaranteed. The IDB will shift its focus to municipal loans and private partners, and may be interested in agricultural loans in the future.

110. (SBU) CAF expects project-specific loans for social spending and domestic debt restructuring to continue, although reporting requirements have not yet been met. CAF does not expect to provide new loans for budget support. A \$250 million CAF loan was supposedly close to approval in late 2006, and outgoing Ministry of Economy officials expected that the loan would be disbursed in early 2007.

111. (U) At his January 17 press conference, Minister of Economy Patino announced that the GOE would not repay a \$3.5 million loan from the InterAmerican Development Bank for trade capacity building to prepare Ecuador for the U.S.-Ecuador Free Trade Agreement. Patino said that \$900,000 had been used and the GOE would request that no further funds be disbursed.

Comment

112. (SBU) It's going to be a bumpy ride as the GOE tries to find some strategy to reduce its external debt obligations. About the only constant we can find so far in Correa's and Patino's statements is a belief that much of the GOE's external debt is somehow illegitimate and the this administration is determined to reduce the debt burden in some way. At least Patino is talking about finding some sort of "friendly" restructuring, but that will be hard to do

given the bondholders' belief that Ecuador has the capacity to pay combined with Correa's and Patino's hostility to foreign debt and their inexperience in dealing with the financial community. Given Patino's evident willingness to reject debt to the multilateral development bank for programs that he considers inappropriate, it appears that the multilateral development banks will also be pulled along on this bumpy ride.

Jewell